



SUPPLEMENTAL RISK DISCLOSURE INFORMATION

Alternative Investments
Integrity. Knowledge. Experience.

When considering alternative investments, such as hedge funds and managed futures, you should consider various risks including the fact that some hedge fund and managed futures products use leverage and other speculative investment practices that may increase the risk of investment loss, can be illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees, and in many cases the underlying investments are not transparent and are known only to the investment manager.

With respect to alternative investments, such as hedge funds and managed futures, in general, you should be aware that:

- Returns from some alternative investments, including hedge funds and managed futures, can be volatile
- You may lose all or portion of your investment
- With respect to single manager products the manager has total trading authority. The use of a single manager could mean a lack of diversification and higher risk
- Many alternative investments that include hedge funds and managed futures are subject to substantial expenses that must be offset by trading profits and other income. A portion of those fees is paid to Altegris
- Trading may take place on foreign exchanges that may not offer the same regulatory protection as US exchanges

With respect to an investment in a hedge fund or managed futures fund, you should be aware that:

- There is often a lack of transparency as to the fund's underlying investments
- With respect to hedge fund of funds, the fund's manager has complete discretion to invest in various sub-funds without disclosure thereof to you or to us. Because of this lack of transparency, there is no way for you to monitor the specific investments made by the hedge fund or to know whether the sub-fund investments are consistent with the hedge fund's historic investment philosophy or risk levels
- A hedge fund of funds invests in other funds and fees are charged at both the fund and sub-fund level. Thus the overall fees you will pay will be higher than you would pay by investing directly in the sub-funds. In addition, each sub-fund charges an incentive fee on new profits regardless of whether the overall operations of the fund are profitable
- There is no secondary market for fund interests. Transfers of interests are subject to limitations. The fund's manager may deny a request to transfer if it determines that the transfer may result in adverse legal or tax consequences for the fund

A hedge fund's Offering Memorandum or a money manager's Disclosure Document describes the various risks and conflicts of interest relating to an investment and to its operations. You should read those documents carefully to determine whether an investment is suitable for you in light of, among other things, your financial situation, need for liquidity, tax situation, and other investments.

Keep in mind that the past performance of any investment is not necessarily indicative of future results. You should only commit risk capital to any Investment Product. Alternative investment products, including hedge funds and managed futures, are not for everyone and entail risks that are different from more traditional investments. You should obtain investment and tax advice from your advisers before deciding to invest.

FROM THE DESK OF JON SUNDT

-- Uncertainty: The New Solid Ground -- 2nd Quarter 2004

In the quoted law “if we know the present exactly, we can calculate the future” - it is not the conclusion that is wrong but the premise.

Heisenberg, *Uncertainty Principle Paper*, 1927

Werner Heisenberg (1901 - 1976) was one of the greatest physicists of the Twentieth Century. In the development of his famous *Uncertainty Principle*, Heisenberg revealed something that investment professionals have also come to discover – knowing the present exactly is extremely difficult if not impossible, and as a result, calculating the future is at the best of times an imprecise science. Let's consider a simplified example. How many of us, by looking at a photograph of a moving car, are able to tell where it is headed, or when it will get there? How are we able to know, by this snapshot, if the car is about to change directions, speed up or slow down?

The markets present a similar problem. While we can, in effect, take a series of 'snapshots' of the present market from different angles, to try and determine what is really happening, even the experts can disagree on how to interpret the resulting information. In short, how can we hope to predict what the markets will do in the future, when the experts can't even agree on the market's present state?

You and I, as investors, spend a lot of time trying to determine the present state of the market. The desire to understand the present environment is completely understandable. Many of us feel the only way to be a successful investor is to identify “where we are” and then place our bets. Is this a bear market rally? Is the bull back? Is the dollar fairly priced currently? Where are we in China's business cycle? There are countless books, newsletters and economists that offer varying opinions regard-

JON SUNDT, PRESIDENT



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ing these scenarios. All this thinking focuses on what I will call a 'deterministic' viewpoint – the belief that future events are entirely dependent on a specific set of variables in place today. If you buy into this approach, then it is only natural to want to completely understand the present. Maybe, just maybe, if we read all the signals right, we will unlock the future. Get it “right” and you're a hero.

What happens when we don't get it right? I'm sure many of you know the answer. How many of us got caught in the gold retracement? Or the dollar rally? How about the tech wreck? If we load up on a deterministic bet, we can get caught.

Despite these lessons, over the next year some will determine gold is the best investment and pour money into gold stocks and the physical gold markets. Some will determine we are on the precipice of a bear market and will avoid anything to do with equities. Some assume a cash only position, and some will avoid all real estate investments. Some will bet that the bull is back and dive deep into stocks. Some of these decisions may be right, others wrong.

SPECIAL REPORT - 2nd Quarter 2004

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These decisions, all based on an attempt to determine “where” we are in the valuation of assets, are at the core of the modern financial services world. As I said, the desire to comprehend the present is understandable, and I’m not saying this approach is necessarily flawed. What has become clear, though, is that it is very hard to be ‘right’ on the present state of the markets with any sort of consistency and maybe harder still to use that information to make money in the future.

A Meeting of Minds and Methods in La Jolla

To illustrate this point more clearly—the difficulty of reading the present state of the markets—let me tell you a little about our first Accredited Investor Strategic Investment Conference. Altegris Investments, along with my good friend John Mauldin, held a conference in La Jolla this past April. Two hundred high net worth investors, family offices and investment professionals came to La Jolla for three days. The idea of the conference was simple: bring together some of the best known minds in market analysis with some of what we think are the most promising hedge fund managers out there. Investors would then hear not only the most up-to-date theories on where the market may be heading, but also individual hedge fund managers speaking about investment strategies they use to take advantage of various market scenarios. This was done through individual presentations, panel discussions, debates and audience Q & A.

So what transpired? Included in this newsletter package is a one-page conference summary outlining presentations from the key speakers. At the risk of gross oversimplification, this summary will at least give you a flavor of the diversity of opinions on the market that this group collectively held. It’s definitely worth a read. In the end we were left with a wide spectrum of opinion from seven respected thinkers in this space. These speakers - and remember, these are some of the best thinkers around - were not of one mind as to where we are now or where we will be in the future.

Embracing Uncertainty

Given this broad range of thinking on the direction of the markets, and given the stature of the presenters that spoke, it is easy to forgive even the most rational investor for feeling uneasy. In this present environment, the prospect of putting money at risk using a strategy strongly tied to a particular ‘deterministic’ market view is unappealing at best. So what’s an investor to do?

I believe the answer lies in coming to terms with what Heisenberg’s research uncovered in the field of physics: that we cannot expect to accurately predict the future given this present environment. There are quite simply too many mixed signals, and too much uncertainty. In my view, we just cannot expect to understand the present situation with any exactness. Perhaps a more reasonable approach would be to embrace the uncertainty. Once we embrace the uncertainty, we may be able to use it to our advantage.

“We need to find investment strategies that have the potential to turn uncertainty on its head and make it a solid platform on which we can build.”

What does embracing uncertainty mean in the context of investments? You may be thinking that the most obvious solution is diversification. You would be right. After all, if you invest in many different places, chances are some will be successful, no matter which market unfolds. But we need to be careful here. My idea of diversification isn’t a 60/40 blend of stocks and bonds. The key to the diversification solution is finding investment strategies that aren’t necessarily hitched to one particular view of the market, but rather are free to exploit change. We need to find investment strategies that have the potential to turn uncertainty on its head and make it a solid platform on which we can build.

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RESEARCH ON THE ROAD



Our research team is continually evaluating existing and emerging products, as well as keeping on top of the industry as it evolves. Matt Osborne, Dick Pfister and Toby Fulton together make up what I think is one of the most insightful research teams in the alternative investments space. Here's some of what they're up to outside of our offices here in La Jolla:

Matt and Toby were in Lausanne, Switzerland June 8th to 10th to attend the Global Alternative Investment Management Forum (GAIM). The conference focused on the growth of the hedge fund industry and featured breakout sessions with leading and emerging managers.

The team attended the Managed Funds Association (MFA) conference in New York the week of June 14th. The MFA represents professionals in the global alternative investment industry. While on the East coast, the team also took the opportunity to meet with some existing and prospective hedge fund managers based in Manhattan, Greenwich and Stamford.

For the right investors, this is where hedge funds come in. I must stress that hedge funds are not right for everyone. Hedge funds do entail some unique risks, some of which are explained in greater detail at the end of this letter. But for qualified investors, the fact that some hedge fund strategies are uniquely designed to thrive on uncertainty may make them good candidates for further investigation. A couple of examples: Long-Short managers can trade both sides of the market and have the potential to capitalize on market moves that long-only strategies would find very difficult. Bi-directional Global Macro traders have the potential to make money on moves in currencies, metals, energy, stock indices and more. The list goes on, with dozens if not hundreds of unique hedge fund strategies available to choose from, many of which are designed to attempt to exploit uncertainty in the markets.

Moving from theory to practice, the second element of the conference focused on presentations by some promising alternative investment managers using some of the most interesting strategies we have researched. What do these managers think of the present markets? For those of you who attended some of these presentations, you'll recall that we didn't typically look to the different hedge fund managers for their opinion on the market direction. In fact, for most of the managers that we had present at the conference, it was clear that they didn't have a specific opinion on the market direction. What they each did have was an opin-

ion on how their trading strategies could respond to the market – how they could embrace and potentially capitalize on uncertainty. They each employ trading strategies that are not highly correlated to equities and are flexible, potentially letting them take advantage of the market whether bull or bear. This, of course, doesn't mean that they can't lose money or will be profitable in all market environments. But it does potentially position them well to respond to different market scenarios.

It is clear that many others are recognizing the value of investment strategies that can profit on uncertainty, such as hedge funds. The latest estimates suggest over \$1 trillion dollars are invested in hedge funds today. And we've moved beyond the level of the individual investor or family office - large public and private institutions such as Yale, Harvard, Princeton and the State of California are pouring billions into these funds, a fact which you may have read about in the mainstream press. While the fact that these institutions are investing in hedge funds may be of interest, it is important to remember that this doesn't mean that any particular hedge fund investment is necessarily right for you, or that individuals have access to the same hedge funds or the same fee structures as institutions. If nothing else, however, you know that there are some bright people at these institutions who understand the value of having alternatives as a piece of their portfolio.

Lets say you do some more research, and come to the decision that hedge funds may be worth looking at. Then what? With over 8000 potential hedge funds out there, the challenge becomes how to invest wisely. The point is really this: while the growth in interest and acceptance of alternative investments is impressive, it too brings with it some uncertainty. With thousands of funds in existence and more emerging each day, the average investor does not have the expertise, knowledge or time to choose and evaluate hedge funds. There are simply too many, and because the industry is less regulated than mutual funds, it is even more difficult to conduct proper due diligence and be confident in your investment decisions.

The best way to make intelligent decisions, in my view, is to ask the right questions, get advice from people you trust and closely scrutinize the answers you get. This is a complex field – it is not easy stuff. Knowing what to ask and how to evaluate the answers requires experience in the complexities of alternative investments. At Altegris, we focus exclusively on alternative investments, and my staff and I have deep industry experience in this area. For the managers that we seek out and put in front of our clients, a key aspect in our due diligence is determining how they expect to make and sustain returns in various market scenarios. One of the primary objectives of our firm is to try to find managers that don't require a rising stock market to make money. We are in a continual process of researching new managers and monitoring the performance of our existing platform of managers. While we don't believe that each manager can always be successful in every market environment, our goal is to offer our clients a broad range of managers that we believe are positioned to do well in a variety of investment climates. Past performance, of course, is not indicative of future performance.

Can Uncertainty Be a Good Thing? Yes and No

For alternative investments, I firmly believe that uncertainty opens up opportunities. Again, it is important to recognize up front, as Heisenberg did, that we can never have perfect information on the present and much less so on the future. However, in my view, if we can ask the right questions and make an effort to deeply understand both the strategies and individual managers, we can better understand which funds are structured to take advantage of the uncertainty in the market, and which are not.

Until next time,



Jon C. Sundt
President

Altegris Investments is headquartered in La Jolla, California, and specializes in offering high net worth individuals and institutions access to hedge funds, commodity trading advisors and managed futures products. Altegris' clients currently represent a trading level of approximately US \$1 billion in hedge fund and managed futures investments. Visit us on the web at www.managedinvestments.com or call us at 800.828.5225 or 858.459.7040.

Alternative investment products, including hedge funds and managed futures, involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager. Alternative investment performance can be volatile. An investor could lose all or a substantial amount of his or her investment. Often, alternative investment fund and account managers have total trading authority over their funds or accounts; the use of a single advisor applying generally similar trading programs could mean lack of diversification and, consequently, higher risk. There is often no secondary market for an investor's interest in alternative investments, and none is expected to develop. There may be restrictions on transferring interests in any alternative investment. Alternative investment products often execute a substantial portion of their trades on non-U.S. exchanges. Investing in foreign markets may entail risks that differ from those associated with investments in U.S. markets. Additionally, alternative investments often entail commodity trading, which involves substantial risk of loss. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

Altegris, a member of NASD and the NFA, offers various alternative investments, including hedge funds, futures funds and managed commodity and futures accounts, that may operate in commodities markets and foreign markets, among others. Altegris and/or its officers/partners may have a financial interest in such alternative investments.

